

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:FSH:MAN:4:TL-N-5384-00
PSchneiderman

date:

to: Sal Baretta, Territory Manager, Natural Resources
ATTN: Revenue Agent John Cleary

from: Area Counsel (Financial Services & Healthcare) (Are 1-Manhattan)

subject:

[REDACTED]
Tax Years [REDACTED], [REDACTED], [REDACTED], [REDACTED] and [REDACTED]
Controlling Authority for Loan Origination Costs Issue

UIL No. 7482.03-00, 7482.13-00

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We write in response to your request for advice in the above-captioned matter. Specifically, you inquired about the the precedential effect of the Third Circuit's holding in PNC Bankcorp, Inc. v. Commissioner, 212 F.3d 822 (3rd Cir. 2000), on the loan origination cost issue you have identified in your case. This matter has been informally discussed with Peter Reilly (CC:PA:APJP), Tina Jannotta (CC:FIP), and Roger Wade (CC:FIP) of the National Office.

This opinion is based upon the facts set forth herein. It might change if the facts are determined to be incorrect. If the facts are determined to be incorrect, this opinion should not be relied upon. You should be aware that, under the routing procedures which have been established for opinions of this type,

we have referred this memorandum to the Office of Chief Counsel for review. That review might result in modifications to the conclusions herein. We will inform you of the result of the review as soon as we hear from that office, which should be in approximately 10 days. In the meantime, the conclusions reached in this opinion should be considered to be only preliminary.

ISSUE

Whether the Third Circuit's holding in PNC Bankcorp, Inc. v. Commissioner, 212 F.3d 822 (3rd Cir. 2000), on the issue of the deductibility of loan origination costs, would be the controlling authority for the loan origination cost issue identified in the subject case.

CONCLUSION

The Third Circuit's holding in PNC Bancorp. Inc. v. Commissioner, 212 F.3d 822 (3rd Cir. 2000), is not controlling authority for the loan origination cost issue in the subject case. It should be noted, however, that the Tax Court judge who hears this case would not be precluded from considering the Third Circuit's decision in PNC and ultimately finding it to be persuasive on the loan origination cost issue.

FACTS

[REDACTED] (" [REDACTED] ") (E.I.N. [REDACTED]), is a Delaware corporation incorporated on [REDACTED]. [REDACTED] is primarily engaged in consumer finance and credit related insurance. For the years under audit, [REDACTED] was a separate corporate entity and the parent of its own group of subsidiaries. During those years, [REDACTED] filed a consolidated Form 1120 U.S. Corporate Income Tax Return using an address of [REDACTED]. Its executive offices were also located in [REDACTED]. Its day to day operations were located in [REDACTED]. [REDACTED] also had a large number of small offices throughout the country transacting its lending and insurance businesses directly with the public.

On [REDACTED], [REDACTED] was acquired in a "B" reorganization with [REDACTED] (" [REDACTED] "), a Delaware Corporation also engaged in consumer finances. At the time of the merger, [REDACTED]'s business address was [REDACTED]. This remains its business address today. Pursuant to the Agreement and Plan of Merger dated as of [REDACTED] ("Plan of Merger"), [REDACTED] merged with [REDACTED], a wholly-owned

subsidiary of [REDACTED], in exchange for [REDACTED] stock. [REDACTED] survived the merger and became a first tier subsidiary of the [REDACTED] consolidated group. Pursuant to the Plan of Merger any notices to be given to [REDACTED] corporation were to be delivered to it at [REDACTED].

Shortly after the merger, up until [REDACTED], [REDACTED] continued to file schedules with the Securities and Exchange Commission using an address of [REDACTED].² We have been advised, however, that as a result of the merger most of [REDACTED]'s management was moved to [REDACTED], where it remains today. We have also been advised that this is where most of the books and records of the corporation are kept. The [REDACTED] address is also the address used by the taxpayer on Forms 872, recently executed by the taxpayer on [REDACTED] and on a Form 870 executed on [REDACTED].³ It is also the location where the Service has been directed to send correspondence to the company. We have also been told that [REDACTED] continues to have some day to day operations in [REDACTED], but on a scale much less substantial than before the merger. In addition, many of its small lending and insurance offices continue to operate throughout the country.

On May 19, 2000, the United States Court of Appeals for the Third Circuit issued an opinion in PNC Bancorp Inc. v. Commissioner, 212 F.3d 822 (3rd Cir. 2000), finding that the taxpayer therein was entitled to claim deductions for loan origination costs as ordinary and necessary business expenses. The Third Circuit's opinion reversed the Tax Court's determination that such expenses were not currently deductible, but were instead amortizable over the life of the loans. PNC Bancorp Inc., et al. v. Commissioner, 110 T.C. 349 (1998). There are no other Appellate court opinions on the deductibility of loan origination costs. Prior to the issuance of Third Circuit's opinion in PNC, the Service and the subject taxpayer had treated

¹ On [REDACTED], [REDACTED] filed a Schedule 13-G with the Securities and Exchange Commission relating to the acquisition of certain securities.

² This information was obtained from the Securities and Exchange Commission's "EDGAR" internet site.

³ IDRS transcripts list the taxpayer's address as [REDACTED]. The taxpayer, however, has advised the agent that this address is merely a location used for processing payroll.

the capitalization of loan origination costs as an agreed recurring issue. Now, based upon the Third Circuit's holding in PNC, the taxpayer is no longer willing to agree to the same treatment in the current audit cycle.

DISCUSSION

The Tax Court adheres to the so called "Golsen Rule" to determine the rule of law it will follow in a particular case. Under the Golsen Rule, the Tax Court will "follow a Court of Appeals decision which is squarely in point where appeal from [its] decision lies to that Court of Appeals and to that court alone." Golsen v. Commissioner, 54 T.C. 742, 757 (1970), aff'd, 445 F.2d 985 (19th Cir. 1971). Thus, for example, suppose the venue for appeal of a taxpayer's Tax Court case lies in the 11th Circuit. Under the Golsen Rule, the Tax Court would be required to follow the rule of law set down by the Court of Appeals for the 11th Circuit, even if courts of appeal in other circuits have differing rules of law and even if the Tax Court, itself, has a differing rule of law.

In the case of a corporate taxpayer seeking redetermination of a tax liability, venue for appeal would be with the United States court of appeals for the circuit where the corporation's principal place of business or principal office or agency of the corporation is located. I.R.C. § 7482(b)(1)(B). The principal place of business, or principal office or agency is determined as of the time the petition seeking redetermination of the tax liability is filed with the Tax Court. § 7482(b)(1). Notwithstanding these provisions, section 7482(b)(2) provides that the taxpayer and the Service may designate the venue for appeal by stipulation in writing.

Little guidance exists as to the interpretation of the terms "a corporation's principal place of business" or "principal office or agency" in the context of section 7482(b)(1)(B). In Peat Oil and Gas Associates, T.C. Memo. 1993-130, the Court analyzed the term "principal place of business" to determine the rule of law to be followed in the case of a petitioning partnership.⁴ Relying heavily on the Supreme Court's opinion in Soliman v. Commissioner, 506 U.S. 168 (1993), (where the term "principal place of business" was examined in the context of a

⁴ Unlike the determination of a corporation's venue for appeal, venue for appeal for a partnership is determined solely by the "principal place of business" of the partnership. I.R.C. § 7481(b)(1)(E). "Principal office or agency" of the partnership is not considered.

claimed home office deduction under I.R.C. § 280A) and available authority on the usage of the term as it relates to corporations, the court concluded that in determining the "principal place of business," "the focus must be on the relative importance of the functions performed at each business location, and that depends 'upon an objective description of the business in question ... so that the decisionmaker can evaluate the activities conducted at the various business locations in light of the particular characteristics of the specific business or trade at issue.'" [citation omitted]. Peat Oil, T.C. Memo. 1993-130.

There is no authority directly on point that defines the term "principal office or agency" as used in section 7482(b)(1)(B). But in a 1973 revenue ruling the Service determined that, for the purposes of the filing income tax returns under I.R.C. § 6091, a corporation's "principal office" is the place where the books and records of the corporation are kept. Rev. Rul. 73-11, 1973-1 C.B. 591. This revenue ruling, however, did not address the "agency" part of the term "principal office or agency."

In the absence of authority interpreting the meaning of the words in a revenue act, courts have looked to the "ordinary, everyday senses" of the words. Crane v. Commissioner, 331 U.S. 1, 6 (1947). Webster's Third International Dictionary (1986) defines "agency" as an establishment engaged in doing business for another. Similarly, Black's Law Dictionary (1979) defines "agency" as a place at which the business of a company or individual is transacted by an agent. Although the term "principal office or agency" is used in the statute with the disjunctive "or," we believe that the word "principal" was also meant to modify the word "agency," so that the reference in the statute is actually to a corporation's "principal office" or to its "principal agency." Any other interpretation would essentially give a corporation with a large presence in one state and small agencies in every other state, a plethora of choices of venue for appeal. We do not believe that this was the intent of the statute. Thus, a fair interpretation of the term "principal office or agency" would be the place where a corporation keeps its own books and records or where such books and records are kept by an agent doing business on behalf of the corporation. This location is not necessarily the same as the location of its "principal place of business." Peat Oil and Gas, T.C. Memo. 1993-130.

In the subject case, the determination of [REDACTED]'s "principal place of business or principal office or agency" has been complicated by its merger with [REDACTED]. Had the merger not taken place, it is quite likely that the Tax Court judge considering the loan origination costs issue in the subject case

would have been bound by the Third Circuit holding in the PNC case. Theoretically, had [REDACTED] remained on its own, it would have continued its operations as it did prior to the merger. Consequently, its "principal place of business or principal office or agency" would most likely have been considered to be in [REDACTED], where its day to day operations were located, or [REDACTED], where its executive offices and business address were located. Since both [REDACTED] and [REDACTED], as well as [REDACTED] and the [REDACTED], are located in the Third Circuit, the Tax Court, following the Golsen Rule, would have been bound by the rule of law articulated by the Third Circuit in the PNC case.

Under the facts of this case, however, [REDACTED] actually merged with [REDACTED]. But the merger, itself, did not have an effect on the rule of law the Tax Court would follow. In general, under the consolidated return regulations, the common parent is considered the sole agent for each subsidiary in the group and is authorized to act in its own name in all matters relating to the tax liability for the consolidated return year. Treas. Reg. § 1.1502-77(a). Therefore, for any given year in which a consolidated return is filed, the entity that is the common parent for that particular year is thereafter the sole agent for any procedural matters that may arise in connection with the group's liability for that year. Southern Pacific v. Commissioner, 84 T.C. 395, 401 (1985).

The relevant procedural matter in the subject case is the filing of a petition in Tax Court. A petition can only be filed by the common parent that was the common parent during the year at issue. J & S Carburetor Co. v. Commissioner, 93 T.C. 166 (1989). If the common parent is no longer in existence, a petition can be filed by a specific designated entity or an alternative agent. See Treas. Reg. §§ 1.1502-77(d) and 1.1502-77T. Here, [REDACTED] survived the merger and continues to exist. It is, therefore, the only entity that can file a petition in Tax Court for the years at issue. Its present status as a 1st tier subsidiary of [REDACTED] is irrelevant. All that matters is that it was the common parent of its own consolidated group for the years at issue and that it continues to exist to this day.

Having determined that [REDACTED] is the only entity authorized to file a petition in Tax Court for the years at issue, we now must focus on determining [REDACTED]'s "principal place of business or principal office or agency." As discussed above, pursuant to section 7482(b)(1), the significant time period is when a Tax Court petition is filed. To date, no petition has been filed in this case, as no statutory notice of deficiency has yet been issued. The statute of limitations on

assessment for the years at issue is set to expire on [REDACTED]. Accordingly, we assume that, if a notice of deficiency is issued in this case, it will be issued shortly and a petition, if filed, would be filed within 90 days thereafter. I.R.C. § 6213(a).

Since you have not indicated to us that [REDACTED] is planning to imminently change or overhaul its business operations, we are assuming that the location of its "principal place of business or principal office or agency" at the time it would file a petition in Tax Court would be the same as it is now. With this assumption in mind, our analysis follows below.

In determining [REDACTED]'s "principal place of business" the focus of the inquiry must be on the relative importance of the functions performed at each business location. Peat Oil and Gas, T.C. Memo 1993-130. [REDACTED] basically has three different business operations: A small day to day operation in [REDACTED]; small lending and insurance offices located throughout the country; and management operations in [REDACTED].

Although we are uncertain exactly what takes place at the [REDACTED], location, we have been told that it is not substantial. Likewise, we are uncertain exactly what activities take place in the small lending and insurance offices throughout the country, but it would seem that in [REDACTED]'s overall business structure the importance of each location would be sleight.

On the other hand, [REDACTED]'s operations in [REDACTED], is where most of [REDACTED] management is presently located. It is the address where the Service has been requested to send correspondence. It is also the location that Beneficial has recently represented as its business address on official IRS Forms 870 and 872. These forms involve agreements between [REDACTED] and the IRS on issues of utmost importance involving income tax examination changes and the extension of the statute of limitations on assessment. The [REDACTED], location is where most of the company's books and records are located.

In comparison to the operations of [REDACTED]'s office in [REDACTED], and of the small lending and insurance offices throughout the country, the operations in [REDACTED], seem more important to [REDACTED]'s overall business. Objectively, it would seem that a company's most important location would be where its management and its books and records are located. Moreover, it would seem that, subjectively, [REDACTED] views its [REDACTED],

location as the most important. This is the address that it has used to identify itself on significant tax documentation and also is the address to which it wants the Service to send important tax correspondence.

As for determining [REDACTED]'s "principal office or agency," the focus is on the place where [REDACTED] keeps its own books and records or where such books and records are kept by an agent doing business on its behalf. Since we are unaware of any agents doing business on [REDACTED]'s behalf, our inquiry starts and ends with a determination of where [REDACTED] keeps its own books and records. As discussed above, most of [REDACTED]'s books and records are kept at its [REDACTED] offices. Accordingly, we conclude that [REDACTED]'s "principal office or agency" is located in [REDACTED], where most of its books and records are located.

Based upon the above analysis, it appears that [REDACTED]'s "principal place of business" and "principal office or agency" are both located in [REDACTED]. Since [REDACTED] is in the 7th Circuit, venue for appeal of a Tax Court case involving [REDACTED] would lie with the United States Court of Appeals for the 7th Circuit, barring any agreement by the parties to the contrary. I.R.C. § 7482(b). Since the Court of Appeals for the 7th Circuit has not yet addressed the issue of loan origination costs, the Golsen Rule would not bind the Tax Court to any 7th Circuit precedent. Moreover, since [REDACTED]'s "principal place of business or principal office or agency" is not located in the Third Circuit, the Tax Court judge hearing the matter would not be bound by the Third Circuit's opinion in PNC. The judge would be free to follow the precedent set by the Tax Court in PNC Bancorp Inc., et al. v. Commissioner, 110 T.C. 349 (1998).

CONCLUSION

Based upon the facts presented, we conclude that the Third Circuit's holding in PNC Bancorp. Inc. v. Commissioner, 212 F.3d 822 (3rd Cir. 2000), would not be controlling authority for the loan origination cost issue in the subject case. Should this case be petitioned in Tax Court, the judge hearing the loan origination cost issue would be free to follow the precedent set

by the Tax Court in PNC Bancorp Inc., et al. v. Commissioner, 110 T.C. 349 (1998). It should be noted, however, that the judge would not be precluded from considering the Third Circuit's decision in PNC and ultimately finding it to be persuasive on the issue.

ADDITIONAL DEVELOPMENT AND CONSIDERATION

At the beginning of this memorandum, we cautioned that our opinion in this matter was based upon the facts set forth herein, which you provided to us. We ask that you take this caution seriously because the facts with which we were provided as to the activities of [REDACTED]'s various business locations were limited. As discussed above, a comparison of such activities is necessary to determine [REDACTED]'s "principal place of business." The determination of [REDACTED]'s principal place of business is key to determining the rule of law the Tax Court would be required to follow in this matter. New facts regarding the relative importance of the activities of [REDACTED]'s various business locations might lead to significant hazards of litigation.

Should you have time to gather additional information from the taxpayer, we suggest that you inquire about the following: The exact function of each of [REDACTED]'s business locations; how that function relates to [REDACTED]'s business as a whole; the activities that take place at each location, the number of employees at each location and their titles, and the type and number of physical structures existing at each location.

Should you obtain any additional information, we would be glad to review it and determine whether such information has an effect on our opinion in this matter. If you have any questions on this memorandum, please contact Paul Schneiderman of this office at (212) 264-1595 ext, 290.

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